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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE reports from business during June have been reassuring, in view of the fears expressed at the beginning of the month that the invalidation of the N. R. A. codes might lead to a period of disturbance in prices and wages, and therefore of general trade unsettlement. Happily these apprehensions have proved to have little foundation. The evidence is overwhelmingly to the effect that the industries intend to abide by the code wage scales as long as they can pay them, and the fear of a general or disorderly breakdown in the price structure has been relieved accordingly. In some lines, including floor coverings, woolen goods and clothing, shoes, and overalls, the trend has been the other way, price advances having been made during the month.

Undoubtedly the suspension of the codes has made merchants cautious. Their general inclination is to give the markets all the time possible to settle down. However, June is normally a slow month in wholesale trade and factory sales, since Summer orders have been placed and Fall buying is hardly expected before the middle of July. Hence there is reason to think that the dullness in the merchandise markets is due as much to ordinary seasonal influences as to uncertainties growing out of the N. R. A. decision. In a few lines such as furs and men's clothing, where up to three months' delivery is customary and early buying is therefore required, business has been in satisfactory volume. Also, reorders of Summer goods have come in steadily. If the experience in these trades holds good in others where Fall buying is due in July, the code uncertainties will not prevent the development of a satisfactory business.

With respect to inventories and retail trade the situation seems healthy. The evidence is that stocks of goods in merchants' hands are light, as might be expected in view of the lack of inducement to buy ahead during recent months. Retail sales have continued to run above a year ago in dollars although prices, except in foods, are a little lower. The largest mail order house for the four weeks ending June 18 reported sales 29 per cent over last year, while its prices according to reliable computations average 7 per cent cheaper.

These sales give evidence of improved buying power, especially in the rural districts. No official figures of farm income are available since April, but the report for that month was extremely favorable; the total, including $50,000,000 of benefit payments, was $507,000,000 compared with $387,000,000 in the same month last year. Moreover, the crop outlook this year is much better, and if crop prices average lower the farmers will make it up by having more to sell. Pastures are greatly improved, and the feeder industries will be in a better position through more favorable margins between livestock and dairy prices and feedstuffs. Thus the farm buying power is expected to continue good.

Of the factors influencing Fall trade the farm income is always the most important. Merchants in the farm States will give good support to the wholesale markets, and if Fall business is reasonably good the danger of wholesale price cutting and wage reductions will be considered over.

The Effort to Maintain Wages

It should be recognized that the ability of the industries to maintain code wages and hours must depend in last analysis upon the state of business. If they cannot sell their goods at prices commensurate with their costs the effort to hold the situation stable will naturally prove ineffective, for either the costs will have to be reduced or the exchange of goods will be disrupted and trade will languish. The fundamental condition of a free flow of trade is that prices of goods and services shall be equitably related, so that each producer can exchange his product equitably with other producers; and the only test which tells whether prices are in equitable relationship is the test of trade itself.

The cotton textile industry is one of those whose ability to maintain the wage scale will

depend greatly upon Fall business; and its situation is illustrative of the principles involved. This industry was the first to adopt a code, and it has properly taken pride in adhering to it, and in the increased wages paid according to code scales. It has voted to continue operating under the code provisions, and desires earnestly to preserve the benefits of its experience in cooperation. However, it has had to carry a three-fold burden of increased costs, namely, the rise in cotton prices under the A.A.A. program, the processing tax, and the rise in wage costs and limitation on machinery operations under the codes.

Under these burdens the industry has lost ground to its competitors, and it is in need of relief. The mills prefer to curtail drastically rather than accept business offered them at a loss, and they are doing so, many shutting down entirely during the first week of July. But obviously shutdowns give no lasting solution of the difficulties either of the mills or of their employes who want work; and unless Fall business is good or relief is given from the processing tax, which is correctly described as a discriminatory sales tax levied upon one industry, the pressure upon wages will be severe. The hopeful aspect is that stocks of cotton goods are everywhere low, and through this period of uncertainty a demand is accumulating which gives promise of the necessary Fall improvement.

It is to be expected that the industries' new freedom of action will lead to adjustments in some directions, such as fitting working hours to local conditions and to the special requirements of certain trades; also possibly in selling terms, and in other ways. However, these adjustments evidently will proceed in orderly fashion, being made in the accustomed manner by individuals trying to make profits or avert losses in their own business. Of course there are places where adjustments ought to be made, to remove restrictions upon the efficiency of the industries and their ability to sell their goods. Changes of this character are endless in the economic system, and are necessary if it is to function and make progress. They are not to be construed as deflationary. They will improve the general situation and enable the industries to do more business.

Good Resistance to Seasonal Decline

The trend of industrial operations during June has been in accord with seasonal expectations, that is, moderately downward. However, when all the returns are in and allowance made for seasonal influences, it is not likely that any marked change in the net situation will be shown. The continuation of the improvement in the stock market after its relapse on the N.R.A. decision, and the advance in the so-called second-grade bonds, give evidence of a hopeful attitude for Fall, and of the expectation that the Summer recession may be less severe than expected.

The general business indexes for the month, and the car loadings figures especially, will show the influence of the abnormal rise in bituminous coal operations in the first half, in anticipation of the strike which was averted, and the compensating drop in the second half. Steel operations, always a good measure of activity in durable goods, have shown a satisfying resistance to seasonal influences, the drop since the last week of May having been only 5 points.

Sales to consumers of electrical appliances, household equipment, and farm implements have continued well above last year. The automobile companies have had good sales except where bad weather has interfered, and in several cases the original schedules for June production were raised after early sales figures came in. It is possible that the June output may be nearly equal to May, instead of showing the usual 10 or 15 per cent decline. Of course May production was reduced and in part pushed ahead to June by the Chevrolet strike, and the current rate of output is 15 to 20 per cent below the season's peak reached at the end of April. However, the record of the industry has been extremely encouraging. It made an early start on the season, and fears were expressed, first, that it was overloading its dealers, and later that accumulations of used cars were becoming troublesome. Nevertheless, cars have continued to sell, and estimates of the year's total business are now substantially larger than those made at the beginning of the year.

Another important quarter in which improvement has been substantial, although activity is still low, is residential building. Residential contracts awarded in thirty-seven Eastern States during May, as reported by the F. W. Dodge Corporation, were 81 per cent larger than in the same month last year. The total for five months was 50 per cent larger and the highest since 1931, and in the first half of June a further increase over the May figures was shown. This increase during the past two or three months has been almost sufficient to offset the decrease in public works construction and to hold the building figures up to last year's level. If public works contracts increase again in the Fall, as expected, the building total is likely to be considerably larger than in 1934.

The encouraging feature of this rise is in the fact that it has consisted almost entirely of privately financed new construction. It is a revival of private enterprise, and therefore it is a mark of better quality in the building figures, and indeed in the whole business situation. Also, the industries are spending more

on equipment, under the influence of their improved sales and earnings, cheap money, and the necessity of keeping costs and prices down in order to be able to pay current wages and still sell their goods. Machine tool orders during May were 60 per cent above last year, and the highest of any month in 4½ years.

Food Prices and the Consumer

Prices of staple commodities have shown some irregularity during the month, but the N.R.A. decision has not been an obvious factor, unless in the case of the non-ferrous metals. Lead, zinc and tin had made good advances on active buying just before the decision, and a reaction has followed. The reduction in the domestic copper price from 9 to 8 cents is a direct effect of suspension of the code. However, copper is expected to be steady at the new level. The industry has made great progress in reducing its stocks, which at latest reports represented about 7½ months' supply, compared with 10 months' at the beginning of the year.

The fears that the N.R.A. decision would lead to immediate disruption of the A.A.A., and the return of cotton, wheat and other farm prices to the depression lows, proved short-lived. Farm prices have eased slightly, but the causes are, first, the resistance of consumers to food price advances which they cannot afford to pay, and, second, the improved crop prospects.

From the low point of the depression to the high of the Spring, which came at the end of April, retail food prices advanced by 38.5 per cent, according to the index of the Bureau of Labor Statistics. About one-half of the advance preceded the drouth, and one-half was due to it. The effect has been to reduce very sharply the consumption of the products chiefly involved, and to turn buyers to cheaper substitutes. The consumption of butter, which climbed to above 38 cents at wholesale in New York last February, has dropped 15 per cent below a year ago, while consumption of oleomargarine has nearly doubled. Also, the price advance brought in imports of butter, which have totaled 23,500,000 pounds this year, against a negligible amount a year ago. As a natural result the price has now dropped below 25 cents, and imports have stopped.

Beef prices at retail are more than 35 per cent above last year, and pork and lard over 50 per cent higher, due to reductions in the supply (Federal inspected slaughter for four months) of 17 per cent in beef, 38 per cent in hog products, and 27 per cent in all meat products. The drop in consumption has been almost as great, some drafts upon storage stocks having been made. Apparently these prices are as high as consumers can pay, since the markets have weakened in the face of continuing short supplies.

Cotton seed oil is another product whose apparent consumption during the past few months has run below a year ago, following the price advance of 110 per cent; and egg consumption likewise has dropped. In all of these commodities imports have risen sharply, tending to check the price advance as soon as quotations reached the world basis plus tariff and shipping charges.

All this gives point to the comment of the Agricultural Adjustment Administrator, Chester C. Davis, in his annual report, that "it is doubtful whether further increases in agricultural prices would be practical at present." Plainly the consumers and foreign producers have something to say as well as the A.A.A. Again the limits on price raising operations are emphasized.

Crop Prospects

The second influence on farm prices is the improvement in crop prospects. The crop season to date provides a great contrast to that of a year ago. Complaints, where there are any, refer not to drouth but to excessive rain. In Southern Indiana and Illinois and much of Missouri the corn planting season was so wet that standard varieties could not be seeded in time, and the land is being put in other feeds or corn for silage. Warm, dry weather is needed over the Corn Belt. Even with an unfavorable start, however, a substantially larger corn crop than last year's is to be expected; and with 21 per cent fewer livestock to feed and Argentine corn offered freely at competitive prices at the ports, the outlook is distinctly more promising for the feeders.

Wheat prospects in the Northwest are exceptionally good. The wheat yield indicated by the Government's June 1 estimate, for Winter and Spring wheat combined, was 670,000,000 bushels, which may have been increased during June. This is in excess of average domestic requirements, the first crop in three years that has produced a surplus. It does not follow, however, that a drop in our wheat price to an export basis is to be expected, since the A.A.A. would probably take care of any manageable surplus, by subsidizing exports from the Pacific Northwest or in other manner.

The improvement in pastures is of great consequence to the livestock and dairy men. In the dairy states the condition June 1 was 78.8 per cent of normal compared with 53.3 last year. This will relieve feeders of expense, and increase the production of dairy products.

It is evident that the shortages caused by the drouth are losing their force in the farm price situation, and that new factors tending to check the rise and perhaps to depress the markets are coming into play. As Mr. Davis

indicates, the A.A.A. will probably not attempt to force more price rises at this time. This puts the burden of any further betterment in price relations between agriculture and the industries, or correction of disparities where they still exist, back on the industries.

Mr. Davis in his report made some comments on this question also. He said:

> Improvement in the exchange value of agricultural for industrial products can be accomplished either through lowering industrial prices and costs or through such a rise in city buying power as would support an increase in farm prices and in the farmers' share of the national income.

The second of Mr. Davis' alternatives is incomparably the more desirable road to improvement. Such a rise in city buying power can readily occur if the barriers of political and other uncertainties which are restricting investment in the capital goods industries can be overcome.

Money and Banking

The past month has witnessed a further increase in the already enormous gold holdings of the United States, and a consequent lifting of actual bank reserves and of reserves in excess of legal requirements to new high records. The principal cause of the increase was the recent crisis in the French franc, which led to heavy exports of gold from France, a large part of which was destined for the United States. Of total gold imports into the country amounting to $236,000,000 during the first 27 days of the month, approximately $204,000,000 came from France, and the remainder chiefly from Holland. In consequence of this movement, the country's monetary gold stock passed the $9,000,000,000 mark, and is now the largest stock, even if valued in old dollars, that has ever been held by this or any other country.

This inflow of gold, amounting in all to $1,940,000,000 since the revaluation of the dollar on January 31 a year ago, has been the primary cause of the great and increasing ease of money. As this gold has come into the country it has been sold to the Treasury, which has paid for it in Federal Reserve funds. As these Federal Reserve funds have been received by the member banks they have been added to the member banks' reserve accounts at the Reserve Banks, thus enlarging the basis for deposits and increasing the supply of lendable funds that has been driving down money rates and lifting the prices of Government and other prime securities to levels not seen in more than a quarter of a century.

Largely on account of this gold inflow, member bank reserve balances show an expansion of nearly a billion dollars in the past six months alone to a total in excess of $5,000,000,000, and are up approximately $2,300,000,000 since the beginning of 1934.

Significance of Huge Increase in Bank Reserves

It is doubtful whether the average person appreciates the significance from the standpoint of potential credit expansion of an increase in bank reserves of such magnitude as is here indicated. These figures are significant because of the relationship between reserves and deposits. Under our laws, banks are required to maintain certain proportionate reserves against deposits—3 per cent against time deposits, and 13, 10 and 7 per cent against net demand deposits, depending upon whether the banks are classified as central reserve city, reserve city or country banks. In other words, every dollar of reserve tends to become the base of an inverted pyramid of bank credit. Thus, if reserves decline, the enforced contraction of bank credit will be many times the amount of the decline in reserves. On the other hand, if reserves are increased, the capacity of the banking system to extend credit is expanded by an amount many times the increase in reserves, and in normal times the lending activities of the banks are such as to assure that this enlarged lending capacity will be availed of.

With this relationship between reserves and deposits in mind, the attention of the reader is invited to the table on the next page showing the trend of monetary gold stocks, member bank reserves and deposits, and money in circulation by years from 1925 to date.

The table shows the great increase that has taken place during the past two years in both the monetary gold stocks and in the reserves of member banks. Monetary gold stocks, of course, constitute the ultimate reserve for all currency and banking liabilities, including even the reserves of the member banks which consist of balances on the books of the Federal Reserve Banks. Before the monetary gold stocks, however, can become a factor in the situation, they must be translated either into added currency issues or additional Federal Reserve credit in the form of member bank reserve balances on which to base deposits.

It will be observed that as compared with the seven-year average, 1925-31, monetary gold stocks have gained over 4½ billions, or slightly more than doubled. At the same time, member bank reserves, while not showing the same dollar gain as gold stocks because of the failure of the Treasury during this period to draw in any substantial quantity on the $2,800,000,000 "profit" on revaluation, have increased by a percentage somewhat greater even than that of the gold increase.

Contrast these huge increases in the credit base with the trend of currency and bank credit actually outstanding! Currency in circulation has increased by something over

GOLD STOCK AND CREDIT OUTSTANDING IN THE UNITED STATES

In Millions of Dollars

June 30	Monetary Gold Stock	Member Bank Reserves	Member Bank Deposits	Total Bank Deposits	Currency in Circulation	Ratio: Member B'k Deposits to Reserves	Ratio: Total Deposits & Currency to Gold
1925	$4,360	$2,191	$32,457	$47,612	$4,811	14.8	10.9
1926	4,447	2,236	33,762	49,733	4,885	15.1	11.2
1927	4,587	2,280	35,398	51,662	4,851	16.3	11.3
1928	4,109	2,342	36,060	53,398	4,797	15.4	13.0
1929	4,324	2,359	35,893	53,852	4,746	15.2	12.5
1930	4,535	2,408	38,139	54,954	4,522	15.8	12.1
1931	4,956	2,396	36,268	51,782	4,822	15.1	10.4
1932	3,919	1,998	27,864	41,963	5,695	13.9	10.7
1933	4,318	2,235	26,587	38,011	5,721	11.9	8.8
1934	7,856†	3,819	31,012	41,857	5,373	8.1	5.3
1935*	9,109	5,029	35,200	—	5,498	7.0	—
1925-31 Avg.	4,474	2,316	35,425	51,856	4,776	15.4	11.6
% Chg. 1925-31 to 1935*	+103.6	+117.2	—0.6	—	+15.1	—	—

* Figures as of June 26; member bank deposits partly estimated. † Includes write-up of $2,800 millions from gold revaluation.

$700,000,000 above the 1925-31 average, due apparently to the slowness of hoarded currency to find its way back into the banks. Member bank deposits, on the other hand, though up sharply from the 1933 low point, are still slightly less than in the seven-year base period. In other words, aside from their impact upon money rates, these added reserves have had little effect thus far upon the credit situation. To date, they have gone unused, awaiting the revival of a demand for money that will absorb them.

It can be taken for granted, however, that money will not lie idle indefinitely. Sooner or later the demand for credit will reassert itself, and lead to advances in bank credit commensurate with the increase in bank reserves. An indication of what a full utilization of the existing reserves would mean in the way of deposits may be had by reference to the column of the table showing the ratio of member bank deposits to reserves. It will be seen that during the period 1925-31 member bank deposits held, with but slight variation, around an average of 15.4 times reserves, dropping in 1934 and 1935 to 8.1 and 7 times reserves, as deposits failed to increase proportionately with reserves. If on existing reserves of approximately 5 billions credit were to be expanded in the ratio of 15 to 1, the resulting member bank deposits would be in the neighborhood of $75,000,000,000, or more than twice as large as during the 1928-29 boom.

In like manner, the figures in the last column covering the ratio of total deposits of all banks in the country, plus currency outstanding, to gold stocks reveal a huge margin for further expansion. Were credit to be expanded on the basis of the present gold stocks in the same average ratio as prevailed in 1925-31 (11.6 to 1), the resultant aggregate of all deposits would be around $100,000,000,000 (assuming no further increase in currency liabilities).

Continued Piling Up of Reserves a Source of Anxiety

The existence of this enormous and growing quantity of surplus lending power constitutes a source of anxiety to all who look forward to the time when it may be necessary to impose a curb on a rising tide of speculative activity. If at such time the banks are in possession of great quantities of excess reserves, rendering them independent of the Federal Reserve Banks, it is clear that the difficulties of exerting credit control through the customary agencies of the rediscount rate and open market operations will be greatly increased. At the present time excess reserves of the member banks amount to around $2,500,000,000, or about equal to the total Federal Reserve credit outstanding. This means that should the entire Federal Reserve portfolio be liquidated the effect would be to merely mop up the excess reserves, leaving the market still free of any large dependence upon the central bank. And this, be it further noted, is without allowing for such further increase of bank reserves as may result from continued gold imports, the return of currency from hoarding, purchases of silver, or use of the Stabilization Fund.

To be sure, the Reserve Banks have the power, granted under the Banking Act of 1933, to raise reserve requirements, if necessary, in order to check undue expansion, and a broadening of these powers is now under consideration in connection with the banking bill now pending in Congress. Undoubtedly, the Reserve Banks under this authority could take steps, if they so elect, to reduce reserves to more manageable proportions. The difficulty about such a course, and indeed about any program of credit restriction, is that it would almost certainly cause a break in the bond market and particularly in the market for Government securities. Prices in these markets, having been pushed up to the current

levels by a monetary policy that has permitted and encouraged the accumulation of heavy excess reserves, require a continuation of this policy in order to hold at these levels. In other words, as so often happens when artificialities are introduced into the situation, an abnormal condition has been created which may prove extremely difficult of adjustment without serious disturbances of far-reaching character.

Money Rates and Bond Prices

Whatever the ultimate consequences of the steady piling up of surplus funds, the immediate effects continue to be pressure on money rates and strength in high grade bonds. While Stock Exchange money rates, bank acceptances and commercial paper remained unchanged at the low levels quoted for some time, weekly offerings of Treasury bills have tended towards a slightly lower basis, issues of $50,000,000 133-day bills and of $50,000,000 273-day bills being taken at the close of the month at nominal rates of 0.07 per cent and 0.123 per cent respectively, which is a shade lower than at the close of last month. In line with the trend of money rates and declining bond yields, the New York State Banking Board announced a reduction in maximum rates of interest to be paid by State banks, including savings banks, to 2 per cent, effective October 1, as against a maximum of 2½ per cent in effect previously. This will automatically affect National banks located in New York State, which under present law are not permitted to pay interest at a rate in excess of that allowed State banks in the same State.

Bond prices continued firm, with advances in many departments. Governments were generally strong, closing at the highs for the month, and in some cases at the highs for all time. Treasury 4¼s of '57 (optional '47), for example, reached a new high at 117, at which the yield was 2.62 per cent. State and municipal issues were affected bullishly by the proposed new tax schedules and by the proposals to do away with new issues of tax-exempt securities. Evidence also of the appetite for prime securities appeared in the reception accorded an issue of $100,000,000 Treasury 3s of 1946-48 offered for competitive bidding, which was four times oversubscribed at an average price of 103 18/32 or 14/32 above the average price on the last $100,000,000 sold under competitive bidding on May 29.

Refinancing continued active during the month at rates representing substantial savings to borrowers. Prominent among the offerings to repay higher coupon issues were $239,000,000 Federal Land Bank 3s due 1955 (optional '45) at 98½, to retire outstanding 4s, the new rate marking a new low record for Federal Land Bank offerings. Other important refunding issues of the month included $30,000,000 Pacific Gas and Electric first and refunding mortgage 4s of 1964 at 104, to retire outstanding 5 per cent bonds of subsidiaries; $29,500,000 Commonwealth Edison first mortgage 3¾s of 1965 at 98, to retire outstanding 4½s and 5½s; and $25,000,000 American Rolling Mill ten-year 4¼ per cent convertible debentures at 100, partly to retire outstanding higher coupon issues and partly to finance new construction.

Satisfactory progress was reported by the Treasury in the refinancing of $325,000,000 Home Owners Loan Corporation 4s called in May for redemption July 1st, all but $80,000,000 having been turned in for exchange into new four-year 1½ per cent bonds of the Corporation, guaranteed both as to interest and principal by the Government. Funds to provide for 4s not tendered for exchange have been raised by sales through the Federal Reserve Banks of additional 1½s for cash.

The foregoing showing as to investment yields is indicative of the decline that has been taking place in the wages of capital, and is pertinent to the constantly repeated charge that capital has not borne its share of the burden of the depression.

The Half-Year Record of New Security Offerings

The volume of new security issues during the first half-year increased considerably over that of the first six months of last year, due principally to offerings for refinancing purposes and for financing municipalities, States and agencies of the United States Government, such as Federal Land Banks and Home Owners' Loan Corporation. A relatively small portion represented new capital raised for investment in the industries and the public utilities. While the volume of new issues has recovered materially from the low level of 1933, it is still far below that of pre-depression years. A summary of publicly offered issues, other than direct obligations of the United States Government, is given on the following page, based on figures for five months, as compiled by the Commercial and Financial Chronicle, and preliminary figures for June.

It will be seen that borrowings by municipalities, States, Government agencies, etc. accounted for about 71 per cent of new issues this year. Of the grand total, corporate refunding amounted to 24 per cent, and corporate issues involving new capital to but 5 per cent.

The tabulation does not show the largest borrower in the market, which is the United States Government. Between January 1 and June 30 the Treasury made 45 new issues of securities, including refunding issues and ex-

changes, equivalent to an average issue of about $150,000,000 every four days.

New Security Offerings in the United States
(In Millions of Dollars)

	First Half Year 1929	1933	1934	1935
Corporate				
New capital	$4,699	$ 60	$ 99	$ 87
Refunding	865	157	102	470
Total	5,563	219	202	557
Municipal, State, Etc.				
New capital	663	209	451	352
Refunding	8	17	69	243
Total	670	226	520	595
U. S. Govt. Agencies				
New capital	—	11	54	9
Refunding	—	—	244	762
Total	—	11	298	771
Foreign Govt., Etc.				
New capital	72	—	—	—
Refunding	8	60	—	—
Total	80	60	—	—
Grand Total				
New capital	5,433	280	604	449
Refunding	880	237	416	1,474
Total	$6,314	$517	$1,020	$1,923

Foreign Exchanges Steady

The foreign exchanges have been quiet and generally steady during the month. Following the formation of the new French Cabinet headed by M. Laval, to which the French Parliament granted emergency powers looking towards an improvement in the Government's budgetary position, the panic over the franc subsided and the market appears to have settled down to a waiting mood. With the Parliament soon to adjourn until Fall, the prevailing opinion appears to be that the franc is safe for the time being at least. Reflecting a cessation of the gold drain towards the latter part of June, and some slight recovery in gold holdings, the Bank of France reduced its rediscount rate from 6 to 5 per cent. Similarly, an easing of tension was indicated in the Dutch monetary situation by a lowering of the official bank rate of the Netherlands from 5 to 4 per cent.

Silver prices have continued to react from the high level of 81 cents reached in the latter part of April under the influence of worldwide speculation induced by the United States buying program. During the past month the price fell from 74½ cents to 69¾ cents, apparently under pressure of liquidation by speculators who had been disappointed in the volume of purchasing by the United States Treasury. Reports in the market are to the effect that Indian selling has been influential in the decline. The Treasury, however, continues to purchase newly mined domestic silver at 77.57 cents an ounce.

The extent of progress achieved thus far by the Treasury in carrying out the terms of the Silver Purchase Act calling for the purchase of silver until the total of such stocks valued at $1.29 an ounce equals one quarter of the total monetary stock of gold and silver combined, was revealed within the month by Secretary Morgenthau in a letter to Senator McCarran of Nevada. In this letter, the Secretary placed the total amount of silver acquired in the ten months ended May 31, 1935 at 421,497,000 ounces, compared with an estimated world production during this period of 156,000,000 ounces.

At the time of the passage of the Silver Purchase Act last Summer it was estimated that the terms of the Act would require the purchase of about 1,300,000,000 ounces of silver. Since then, however, approximately $1,152,000,000 in gold has been added to monetary stocks, requiring at the 3 to 1 ratio additional purchases of around 300,000,000 ounces of silver. Thus, despite the acquisition of 421,497,000 ounces of silver in the past ten months, the Treasury is only about 121,000,000 ounces nearer its goal than when the program started, having 1,180,000,000 ounces still to go before it can attain the objective of the bill.

United States Government Finances, 1934-35

For the fiscal year just closed Treasury accounts through June 24 indicated that the Government was more successful in balancing revenues and expenditures than had been anticipated. Whereas President Roosevelt in his January budget message had forecast a deficit of $4,869,000,000, it is now apparent that the figure will be approximately $3,500,000,000. What is perhaps more significant is the fact that the deficit will also be about $400,000,000 less than a year ago, which would be the first time that the annual deficit, beginning in 1931, has failed to increase over that of the preceding year.

True, a deficit of $3,500,000,000 is no great cause for self-congratulation, particularly in view of the fact that except for 1934 and the two war years, it is still the largest on record. Moreover, such improvement as has taken place over 1934 has not been due to a reduction of expenditures, but to an increase in the returns from taxation. Expenditures continued to increase, and through June 24 aggregated $7,191,000,000, or the largest for any peacetime year. Until there has been demonstrated an ability to balance income and outgo through a reduction of outgo the situation must continue to be considered unsatisfactory. The history of public finance has made it clear that in any race between expenditures and revenues, expenditures will always win. Unless there is a willingness to apply the brake upon spending, revenues are sure sooner or later to be outdistanced.

Those who advocate the spending program count upon recovery to solve the problem of the budget by bringing in enlarged revenues, while at the same time permitting a tapering off in expenditures. Perhaps it will work out this way. It is to be sincerely hoped that it will. However, dependence upon such a course involves taking chances on several unknowns, including the length of the depression, the extent to which revenues could be increased in the recovery, and the willingness of vested interests which have grown accustomed to the receipt of funds from the Federal Treasury to see their advantages curtailed.

Mr. Lewis Douglas, former Director of the Budget in the Roosevelt Administration, has recently pointed out that in 1919, when the income tax rates were higher in the lower brackets than they are today, when we had in effect excise taxes, though not quite as many as we now have, and when we had full industrial production, we collected $6,600,000,000 in income, the largest amount that has ever been collected in our history. Yet the Administration plans, as Mr. Douglas points out, call for the spending of $8,500,000,000, which would still leave a gap of $1,900,000,000 even on the basis of a recovery as great as that of 1919.

It will be said, of course, that this gap will be bridged by retrenchment. But can we be sure of this? Will the Government be able to stop spending when it wants to? Will the people who have become used to relying upon Federal aid take kindly to its reduction or elimination? Will the great army of office holders built up to conduct the great national spending program willingly see itself demobilized? Experience justifies serious doubt. Human nature is such that people who have been the recipients of special favors soon come to look upon them as rights, and resent their termination with a bitterness which often wipes out the memory of original benefits. It is this difficulty of going into reverse, of economizing at the cost of popular favor, which makes government embarkation on a large program of expenditure a matter of concern to so many people.

It will be recalled that when the budgets for the years 1934 and 1935 were presented in January, 1934, it was planned to balance the accounts after June 30, 1935, and to arrest further borrowing. Now, however, that June 30, 1935, is here a balanced budget seems as remote as ever, and an actual deficit of $4,529,000,000 for 1936 is indicated.

Government Revenues Up Sharply

The increase in Government receipts this year included substantial gains in most all of the important sources of revenue. Miscellaneous internal revenue, which now provides nearly one-half of total receipts and comprises the excise and manufacturers' taxes on cigarettes and cigars, liquors, gasoline and oil, theatre admissions, electrical energy, telephone and telegraph messages, stock and bond transfers, automobiles, tires and various other products, was materially higher, reflecting the increased rate of activity in numerous lines of industry. Customs duties also rose as a result of large merchandise imports at higher prices. Income taxes paid by corporations and individuals were more than 30 per cent higher, due to the improvement in business profits, combined with the limitation of security losses in computing taxes, the elimination of consolidated returns and other provisions tightening up the tax laws.

The rise of over 40 per cent in processing taxes on agricultural products is due to the fact that some of the taxes were in effect for only part of the preceding year and some of the rates were formerly lower. Receipts from foreign governments on account of war debts declined to a nominal amount this year and income from Government-owned domestic securities was lower. On the other hand, the "seigniorage", or profit on coinage of silver, a bookkeeping entry of misleading significance, contributed nearly $60,000,000 to the Treasury this year as compared with a negligible amount in prior years.

Government Receipts, 1934-1935
(In Millions of Dollars)

Receipts	Fiscal Years 1934	1935*
Income taxes	$ 818	$1,094
Miscellaneous internal revenue	1,470	1,638
Processing tax on farm products	353	520
Customs	313	338
Proceeds of foreign obligations	20	1
Seigniorage	—	58
Other receipts	142	119
Total receipts	$3,116	$3,768

* Through June 24.

Government Expenditures at Peace-Time Peak

Government expenditures through June 24 aggregated $7,191,000,000, against $7,105,000,000 for the full 1934 fiscal year. There was an increase in the total departmental expenditures, covering the regular civil government departments, independent offices and commissions, reflecting the increase in number of employes and the restoration of the salary reductions formerly in effect. There were also increases in expenditures for the Army and Navy, Veterans' Administration, interest on the public debt and in benefit payments to farmers under the A.A.A., also in public debt retirement charges against the sinking fund. Expenditures for public building construction and for river and harbor work classified under "general expenditures" were less than in the preceding year, but total expenditures of these types were larger, the difference being listed

under the "emergency expenditures" division in the budget.

Of the emergency expenditures, the total of which is approximately equal to the total of general expenditures and also is roughly equal to the deficit, the largest item is that of F.E.R.A., which superseded the old C.W.A. Total expenditures for direct relief, including the Civil Conservation Corps and drought relief administered by the Department of Agriculture, were materially larger this year than last. Expenditures of the Public Works Administration, part of which represents loans to be repaid in the future, also increased, but were below estimates, due to the continued delay in getting local governments to approve the necessary borrowing and in getting individual projects actually under way.

The Reconstruction Finance Corporation had an excess of advances on new loans over collections on existing loans of only $362,000,000 this year, whereas last year the corporation made unusually large disbursements for loans and for the purchase of preferred stock of banks and had a net draft on the Treasury of $1,615,000,000. There was also a decline this year in subscriptions by the Treasury to capital stock of the Federal Deposit Insurance Corporation and other Government credit agencies.

Government Expenditures, 1934-1935
(In Millions of Dollars)

General	1934	1935*
Total departmental	$ 341	$ 351
Public building	76	25
River and harbor work	78	54
National defence—Army	205	218
National defence—Navy	274	316
Veterans' Administration	507	553
Soldiers' bonus certificates	50	50
Agricultural Adjustment Adminis.	280	556
Refunds of receipts	64	75
Postal deficiency	52	40
Interest on the public debt	757	805
Sinking fund for debt retirement	360	573
Other general expenditures	49	47
Total general expenditures	$3,101	$3,664
Emergency		
Agricultural Adjustment Adminis.	$ 72	$ 150
Farm Credit Administration	67	111
Federal Emergency Relief Adminis.	341	1,248
Civil Works Administration	716	11
Emergency Conservation Corps	332	424
Department of Agriculture—relief	—	80
P. W. A.—Loans to railroads	71	67
P. W. A.—Loans, grants to states, etc.	79	135
P. W. A.—Public highways	268	314
P. W. A.—River and harbor work	72	146
P. W. A.—Other expenditures	166	384
Reconstruction Finance Corporation	1,615	362
Federal Deposit Insurance Corp.	150	—
Other emergency expenditures	56	94
Total emergency expenditures	$4,004	$3,526
Total expenditures	$7,105	$7,191

* Through June 24.

Although the combined total of all expenditures increased only moderately in the 1935 fiscal year as compared with 1934, an unfavorable feature is the decline in those expenditures which represent loans and investments on which a substantial recovery by the Treasury may be expected and on which large repayments were made into the Treasury in 1935, whereas there was an expansion in the non-recoverable expenditures for relief as well as in general expenditures.

Direct and Guaranteed Debt

The deficit this year was financed in part by an increase in the public debt and in part by drawing down the cash balance in the general fund of the Treasury. There have been deficits in each of the past five fiscal years, the cumulative total of which is $14,500,000,000, while public debt has been increased from $16,026,000,000 to $28,629,000,000.

In addition to the direct public debt, there has been a marked expansion during the past two years in the debts of the various Government credit agencies, such as the Home Owners' Loan Corporation, Federal Land Banks, Federal Farm Mortgage Corporation, Federal Intermediate Credit Banks and others, whose figures do not appear in either the general or emergency budgets. On April 30, 1935 these agencies had liabilities of $3,731,000,000 which were guaranteed by the Treasury and liabilities of $2,648,000,000 which were not guaranteed, excluding inter-agency liabilities, and the contingent liability for Postal Savings deposits was $1,200,000,000. The liabilities of these agencies are of course offset by the assets which they hold in the form of loans, investments, Government securities and cash.

A condensed summary of Government finances since 1913 is given below, showing total receipts, expenditures, surplus or deficit and direct public debt:

United States Government Finances
(In Millions of Dollars)

Year Ended June 30	Total Government Receipts	Total Government Expenditures*	Surplus or Deficit*	Gross Debt June 30
1913	$ 724	$ 725	—	$1,193
1914	735	735	—	1,188
1915	698	761	— 63	1,191
1916	783	734	+ 48	1,225
1917	1,124	1,978	— 853	2,976
1918	3,665	12,698	— 9,033	12,244
1919	5,152	18,523	—13,371	25,482
1920	6,695	6,482	+ 212	24,298
1921	5,625	5,538	+ 87	23,976
1922	4,109	3,795	+ 314	22,964
1923	4,007	3,697	+ 310	22,350
1924	4,012	3,507	+ 505	21,251
1925	3,780	3,530	+ 251	20,516
1926	3,963	3,585	+ 378	19,643
1927	4,129	3,494	+ 636	18,510
1928	4,042	3,644	+ 399	17,604
1929	4,033	2,848	+ 185	16,931
1930	4,178	3,994	+ 184	16,185
1931	3,317	4,220	— 903	16,801
1932	2,121	5,274	— 3,153	19,487
1933	2,238	5,307	— 3,068	22,539
1934	3,116	6,745	— 3,989	27,053
1935†	3,768	7,191	— 3,423	28,634
1936‡	3,992	8,520	— 4,529	34,239

* Includes expenditures for statutory debt retirement.
† Through June 24.
‡ Budget estimate.

The New Taxation Proposals

The new taxation proposals have taken serious form suddenly. The idea of an enforced leveling down of large fortunes to raise small incomes, with restrictions upon future accumulations, has been in circulation for a long time, but practical obstacles have been recognized. The idea springs from an assumption that business is like a game of cards, in that whatever one person gains is at the expense of others, which is not true of legitimate business.

Moreover, it over-emphasizes the feature of competition as against the feature of cooperation. As often set forth in these columns, and again in the last article of this number, the essential principle of the economic system is the exchange of services, which means that it is a system of cooperation in supplying common wants; competition is a subordinate feature, incidental to rivalry in cooperation. Competition arises inevitably from a comparison of goods or services and from freedom of individual initiative and choice. Competition exists not only between like commodities and services, but between different ones; not only between rival automobiles, but between an automobile and a trip to Europe.

The matter of chief importance in economic relations is that we buy other people's services with our own, and that every improvement of methods that increases the common supply is a general gain to the community, regardless of immediate effects among competitors. This is the history of civilization and social progress, and the basis of the maxim that he who makes two blades of grass grow where there had been but one is a public benefactor. In the past this maxim has been held good without limitation.

Business is not a struggle over existing wealth, but an organized system of cooperation in producing and exchanging desirable things. Labor and capital are both required in modern industry—the worker and the equipment with which he does his work—and the greater the facilities for production and exchange, the greater will be the volume of production, of the exchanges and of distribution to all groups and classes participating in the system. This is not the card-game set-up.

The proposed policy is based also upon an assumption that no one derives any benefit from wealth unless he owns it, which will not stand examination for a moment. It is like saying that no one has derived any benefit from the development of the steam engine unless he owned an engine, or from railroads unless he owned railroad stock or bonds, or from the development of electricity unless he owned public utility securities, or from any industrial development unless he had money invested in it. Contrary to this, it is well known that the changes in industry throughout the past have been steadily raising the living conditions of all the people, and that the humblest wage-earner in the land is benefited by every improvement in industry or trade that increases the purchasing power of his wage. The benefits of capital are diffused by use, and by the fact that it cannot be used without the employment of labor.

Wealth Used in Production

The fortunes under discussion are in the form of income-producing property as a rule, engaged in the production of goods and services for the market, other wealth being of insignificant proportions. A fortune may have been inherited, but aside from land, productive property rapidly loses its value by use and obsolescence, unless continually made over or replaced. It is not idle wealth, and the public pays nothing for its use unless it renders service. The public interest is not in the ownership, but in the services rendered.

There can be no limit to the useful production of goods and services for the market, or to the creation of new productive wealth, until the multiplying demands for all desirable things are satisfied; nor does an increase of wealth in the hands of present holders prevent an increase in other hands, but rather promotes it. It is a loss to society to have any useful person retire from work that he is performing capably; there is room for everyone and all that he can do. The existence of unemployment proves nothing to the contrary; unemployment, like disorder in a machine, is something for study by itself. Any policy that looks for abundance, or a larger share for anybody, through limitation or exploitation, will simply reduce the aggregate supply and everybody's share of it.

Everybody should pay taxes to meet the proper expenses of government, but if wealth that is being used productively is drawn upon for that purpose the public suffers by the depletion even more than the owner, who actually withdraws from public use only what he consumes. If the proceeds of taxes are used unproductively, the public will lose, and tax yields will be lower in the future for all such depletion. The public, no more than an individual, can eat its cake and still have it. Every waste is a social loss.

If the method of proposed levies and their effects should be such as to disturb the businesses involved, the tax-income from such sources may be permanently reduced in the future, and their disturbance may affect other incomes and tax-results. A report of the new proposal states that whereas under the present system of estate taxes an administration is allowed eight and one-half years in which to

pay estate taxes, with interest at 6 per cent, twenty-five years will be allowed for the payment of the inheritance taxes, with an interest rate below 6 per cent. These details indicate that the framers of the bill recognize the danger of disturbing reactions. They also indicate that as a source of revenue in the present emergency these taxes are not rated highly.

In short, these fortunes now are a continuing source of revenue to the public treasury, also of employment and of support to other business; but to whatever extent the principal is absorbed by the Treasury they will cease to serve such purposes in the future. Like the spendthrift's inherited possessions, they will be gone.

The graduated corporation income taxes are a hardship upon stockholders of small incomes, for they violate the principle of payment according to means, which is the basis of graduation. They are levied for the purpose of limiting the size of corporations without regard to the utility and economy that result from size, which obviously are greater in some lines of business than in others. The stock of the American Telephone and Telegraph Company was held by 675,000 persons at the date of its last report; the company's business covers the country: why should these investors pay a higher tax than investors of like amounts in a local company?

The policy has no apparent basis but in the erroneous assumption that big corporations leave no place for small corporations, and it overlooks the fact that the public is best served by having all its wants supplied in the most economical manner. All unnecessary costs limit purchasing power, and affect the individual consumer as well as the corporation at which the policy is directed.

All of these gradations are fixed in terms of the dollar, and all of the levies will become more burdensome with any rise of the general price-level. Thus an inheritance which at the present level of prices might be valued between $1,000,000 and $2,000,000 and be taxed 20 per cent, when devaluation and the silver policy have worked their ultimate effects upon prices might be valued at $3,000,000 or $4,000,000 and be taxed at 40 per cent, although the properties of which it consisted remained the same.

The Constitution, the Law and Social Progress

Obviously the unanimous decision of the Supreme Court upon the policy of economic control embodied in the National Industrial Recovery Act and other legislation of that type was a great disappointment to the sincere believers in that policy. Impulsively they have uttered an outcry against both the Supreme Court and the Constitution, the latter as an antiquated document of no binding authority, and the former for not joining in this opinion of the basic agreement upon which this union of States is founded.

This view of the Constitution and the Court is unwarranted. Nobody ever has contended that the Constitution was not subject to change; it provides in itself for amendment and how that may be accomplished. The makers were only concerned that changes should be made deliberately and in order, with such time for discussion and consideration as would afford security against hasty and imprudent action affecting the liberties for which they had fought the war for independence. Our experience with the prohibitory liquor amendment has demonstrated not only that the Constitution can be amended, but that careful deliberation is desirable upon every proposal.

The Constitution is the original grant of authority by the sovereign people to the government of the day, and its limitations stand until the people alter them. It endows the government of the day with large powers, but divides this government into three branches, to wit: the Executive, Legislative and Judicial, each with appropriate responsibilities. It is a government of limited and divided powers, of checks and balances, and was so planned for the protection of the several Commonwealths that were establishing a federal government for certain common purposes, retaining other rights and powers to themselves and to the people in their individual capacities. The more intimate relations of community life were reserved to the domain of the States and their political subdivisions.

In passing upon the Recovery Act the Supreme Court found that the Constitution had been violated in two important particulars. First, Congress had attempted to delegate its law-making functions to the President, who in turn had delegated it to the Recovery Administration, a multifarious and far-extended organization designed to regulate the greater part of all economic relations, while other organizations with similar powers were to regulate the remainder. In the particular case before the Court, the code of rules prescribed the terms and conditions to be observed in the industry of slaughtering poultry and distributing the same by sale, regulating practically all of the details in which competition might develop different costs and prices. The case was typical of the plan, as may be seen by another early enforcement case, (which did not reach the Supreme Court) wherein a tailor was arraigned for making an independent charge for pressing a pair of pants.

The other violation named by the Court was that of treating the slaughtering industry as an interstate business. The Court found that while the poultry dealt in came from num-

erous States, the slaughtering industry was confined to one locality and that the operations of the defendant company were not even subject to regulation by Congress, to say nothing of its delegated authority.

As reviewed by the decision, it is apparent that the Recovery Act would have worked a revolutionary change in our system of government. This is not to say that it was intended by the projectors to be more than a temporary exercise of power, for dealing with an emergency which in their opinion was beyond the provisions of the Constitution; but in the judgment of the Supreme Court, their decision that such an emergency existed and that their proposal would be a remedy for it, was an unauthorized exercise of authority, destructive of the authority of the Constitution. It was passing judgment on the Constitution and superseding it, and in the judgment of the Court, the Congress and Chief Executive have not been so empowered. In truth, the Constitution itself was adopted for protection against emergencies. The country might get along very well in peaceful and normal times without a Constitution; this compact was provided against the rise of extraordinary conditions, when strange proposals might be advanced, when counsels might be confused, and when it would be important that the course should be guided by established principles, instead of by the judgment of the most recently elected Congress and Executive.

The Principles of Our Government

Since the Colonial period, and indeed before, government in this country has been based upon certain definite principles, set forth in written constitutions and historic declarations. Before the Declaration of Independence was adopted, and ten years before the Constitution of the Union was drafted, the people of seven of the States which later formed the Union had declared their political independence, and four of them had adopted constitutions in which the authority of their State governments was defined and the natural rights which were held to be inherent in freemen were excepted and reserved, even against these State governments. Beginning with that of Virginia, these constitutions have all declared for the protection of those personal and property rights which for long before had been the basis of free societies, and of social progress. Every freeman was assured the right to order his own life, subject to the equal rights of his fellows, to bargain for the sale of his labor and to possess the legitimate proceeds of his labor; also assured freedom of speech, of the press, of religious and other beliefs, trial by jury, etc. These rights were not to be encroached upon, and they were believed to assure a state of freedom to individual initiative, ambition, energy and enterprise necessary not only to material prosperity but to the development of the capabilities and character of the people. Subsequent State constitutions were of the same type. The Federal Constitution as adopted by the Convention was primarily devoted to the relations between the States and the Federal Government, but the reservations of individual rights in the State constitutions were thought to be fully ratified and protected. However, objections to the draft were raised on the ground that these reservations should be more specifically recognized, and one State convention (that of North Carolina) refused to ratify on that account. Although ratification was given by the number of States required for the establishment of the new government, the first Congress under that government, in 1791, submitted the first ten amendments, known as the "Bill of Rights", to the States, and ratification was completed in that year. This action shows the importance attached to the protection of individual rights against all government.

The Common Law

Along with the principles embodied in the State and Federal Constitutions, the thirteen original States had received from the mother country the Common Law of England and adopted it as the basis of their jurisprudence. The origin of the "Common Law" was in the customs of the people. To quote the Encyclopedia Britannica, the Common Law is "not set down in any written statute or ordinance, but dependent upon immemorial usage for support. The validity of these usages is determined by the judges." The article on the Common Law in the Encyclopedia Americana describes it as "the spontaneous evolution by the popular mind of rules, the existence of which is proved by their general observance." The origin of Roman law, and of law everywhere, was the same. The people, in their everyday relations with each other, in free societies, evolved certain customs and rules to serve their social needs, and these customs have been defined and amplified by rulers, legislatures and judges, and given the authority of law, because they had the approval and support of the public.

Nowhere, in any general sense, has the law been made and handed down from above: the spade work of social progress has been done by the people themselves, in their voluntary relations, and in working out these relations in this manner the people accomplished their own education in the science of living together in organized society. This is the principle upon which government in the United States was established.

The argument for the Government in behalf of the poultry code sought to make out that

the code had an origin like that of the Common Law, because it was drawn and agreed to by the poultry trade. The Court made short work of its comment upon this plea. It said:

Could trade or industrial associations or groups be constituted legislative bodies for that purpose because such associations or groups are familiar with the problems of their enterprises? And, could an effort of that sort be made valid by such a preface of generalities as to permissible aims as we find in Section I of Title I? The answer is obvious. Such a delegation of legislative power is unknown to our law and it is utterly inconsistent with the constitutional prerogatives and duties of Congress.

Obviously the process of code-making in Washington had only a faint resemblance to the process by which the common law was developed.

The Origin of N.R.A.

Notwithstanding the outcome of the N.R.A., it is right to say that the undertaking had a plausible basis, if considered purely as a temporary expedient and without raising the Constitutional question. It seems allowable now to reproduce the following comment from the discussion of the measure appearing in the July, 1933, number of this publication, the first number following the enactment. The act had been passed and approved, its constitutionality would be passed upon by the courts, and meantime there was need for all possible cooperation:

The National Industrial Recovery Act

The National Industrial Recovery Act is frankly emergency legislation, carrying extraordinary powers, for the purpose of obtaining a concentration of authority believed to be necessary for effective dealing with the disorganization existing in industry. * * * The essential thing is to get the great, normally self-supporting, industrial organization to running again under its own power.

It is undeniable that the organization is seriously out of order. This is what makes the emergency and justifies resort to the powers granted by the act. The volume of all kinds of business has been declining heavily over the last three years, the aggregate in 1932 being scarcely more than one-half of 1929. Since in final results all business consists of an exchange of services, it is evident that the trouble is in the exchange relations. Every one buys with what he sells and although the economic system consists of a multitude of independently-owned units they must work together as a harmonious whole to have prosperity. * * *

Obviously the grant of power is extraordinary, but the undertaking would be impracticable without the concentration of authority. The intent is to restore order in industry and there is no reason to question the declaration of the President and of the Administrator, General Hugh Johnson, that they are counting upon industry to govern itself, with the Administration acting chiefly as Umpire. This would be an ideal development, for it not only would mean success in overcoming this emergency, but yield results of lasting value.

Nevertheless, with the best spirit and motive actuating all participants, the regulation of industry and of competitive relations involves many difficult and important problems upon which opinions honestly differ. The situation calls for a spirit of cooperation on the part of industry, a high order of intelligence and executive ability in the supervisory authorities, and last but not least, a clear understanding of economic principles. * * *

The new organization should be helpful in overcoming the present state of disorganization. It furnishes a meeting ground for interests which really have a common stake in prosperity, but have been accustomed to see their relationships from different angles. If they are brought to a better understanding of the economic system and their mutual obligations in it, much good will be gained. It remains, however, to be seen whether this will occur or whether the seeming investment of power may not stimulate an increase of demands on the government, with "strikes," "holidays," and "marches" on Washington. After all, prosperity and progress must be gained by compliance with economic law, and the new organization will have the greatest possible degree of success if its operations are guided in close conformity to the Law of Supply and Demand.

In the following number, for August, 1933, the discussion was continued, as follows:

Theoretically the gains from centralized control of the economic system may be thought of as possibly very great, but almost everyone will qualify his expectations by saying that "everything depends on the management." It is possible that centralized control of all industry might be so good for a time that the aggregate of results would be above the record of free industry, or so bad as to be far below that record. Under free industry some of the management is good and some of it bad, with the general result that the good succeeds, the bad does not, the waste is charged up to experience, and the record of the last 100 years shows marvelous progress to have been made. Whether progress would have been as great under centralized control as under free industry is a subject upon which any one can have his own opinion. * * *

It is not to be assumed that the experiment in industrial control now being undertaken will be revolutionary in administration or results, or anything more than what it purports to be, viz: a temporary means of aiding private industry to regain its equilibrium, partly through greater freedom in cooperation than the law has hitherto permitted, and partly by the support of law and authority.

The essence of this comment is that theoretically (having regard for emergency conditions only) the plan might be helpful in restoring order, if the authority was used in harmony with the workings of economic law, i.e., to obtain prompt and general cooperation to that end, but would not be helpful if economic law was disregarded.

The Economic Law and Economic System

A gesture of impatience may be noticed when economic law is mentioned, prompted apparently by the idea that economic law is an obstruction to progress set up by the same people who are responsible for constitutions. Economic law, like the Common law, is based upon conditions which the people themselves create in their relations with each other, but unlike the Common law it is not confined to proposals upon which the people have reached agreement, but applies to all sorts of conditions. Moreover, the economic law assumes no authority or obligations whatever; it is simply descriptive of what happens when the people in dealing with each other create certain conditions. The law of supply and demand is just as real as the law of gravitation, and just as unconcerned and impartial whether prices are rising or falling as the law of gravitation has been in its attitude toward aviation. Through knowledge of other physical laws the science of aviation has been developed;

but not without taking account of the law of gravitation; and so, although the demand for, or supply of, any commodity may be altered, the law of supply and demand remains in command. Price fluctuations are caused by the dealings people have with each other; the economic law only explains them.

The "economic system" is no "system" at all except as people voluntarily do business with each other for their mutual advantage. It has no authority over anyone, has been developed without overhead direction, and is a wonderfully serviceable system when all its parts are working together normally. We have referred so often to the specialization of labor and the resulting exchange of services that it seem superfluous to do so again, but all that is to be said for and against the economic system centers in this policy of specialization and exchange.

The principle has been known and practiced for a very long time. Unquestionably the mutual gains have been very great, and are constantly increasing. They grow with certainty by the advancement of learning, by every discovery in the natural sciences, every invention in mechanics, every improvement in business methods and by all accumulations of capital available for investment in industrial equipment and business activities. Every person shares as a consumer in the gains resulting from this always developing organization, but it is evident also that every participant has accepted the condition of membership in a "system". Practically he has entered an ever-extending partnership arrangement, although no agreement of that import has been signed. The substance of it is that he has become part of an organization and that the results of his efforts have become dependent not alone upon them, but upon the harmonious workings of the organization as a whole.

The Authority of the Market

Certain conditions may be noted as naturally attaching to membership in this organization. The combined production goes into a reservoir which is called the "market", from which every contributor is entitled to withdraw whatever the market will give him in exchange for his contribution. The "market" consists of everybody who has something to sell, but each seller is also a buyer, wanting to get as much as possible of the other products in exchange for his own offerings. Market prices are dependent upon a complex of market relations. Every price is related to many prices; indeed every offering competes not only with similar offerings but with every offering that makes an appeal to the purchasing power in the market. The aggregate of purchases is the same as the aggregate of sales; there is no purchasing power in the market but in the products and services offered for sale. Moreover, it is to be noted that every buyer is as free as every other buyer in making his own purchases; the mass demand is the combined demand of the millions of sellers, is impersonal and there is no appeal from its choice. Edmund Burke is quoted as saying that he did not know how to draw an indictment against a whole people; and so it is difficult to see what redress can be had for the action of a free market. It is up to the seller to accommodate his plans and operations to the market, to bring to it something that it wants. The market is too big and multitudinous to be brought to book by his complaints. It answers: "I did not order anything of you; I never heard of you!"

The market is highly complex in its value relations, but the principle by which values are determined is very simple: The offerings must buy and pay for each other. If a market supply exceeds the demand at the usual price, a surplus will remain and obstruct the sale of new offerings. Some inducement must be offered to increase demands or somebody must carry the surplus until it is wanted. In this situation some one will reduce his price, not because he likes to be a "chiseler" but because his circumstances impel him to do so. This has been illustrated in many commodities in recent years. In such a case the supply of that commodity is out of proportion to the total wants and purchasing power of the public. It is a state of unbalanced relations and there is no remedy for it but by the adjustments in supply and demand which naturally tend to be made by the sellers and buyers themselves. When the price of anything falls below the rewards of capital and labor in other occupations, it no longer attracts either, and the unbalanced situation tends to be corrected.

If any single farm product continues to accumulate in stocks and falls in price, year after year, farmers will plant less of that and more of others until the normal balance is restored. By the same logic, if *all* farm products continue to accumulate and fall in price, and the aggregate return from farming is persistently below that in other occupations, there is no escape from the conclusion that farming is relatively overdone, and that a shift of workers to other occupations is desirable. In reaching this conclusion, however, it is necessary to take account of the considerations of every kind which have had an influence in inducing people to be farmers: such as gifts of homesteads by the government, loans of capital and support of various kinds, intended to make the business more remunerative, but having the effect of making it more competitive. Any line of business would be demoralized by that policy.

Like comments apply to all industries and occupations. Nobody planned the economic system. It is a voluntary system: every person is expected to find his own place in it. There is no overhead authority to tell any one what work he shall do or what pay he shall have for doing it—except in penal institutions—and, despite all theories to the contrary, nobody *wants* such an authority over *himself*, even though he may have a benevolent desire to impose his views on others.

The economic system is an organism, and like every kind of an organism, social or mechanical, from a ball game to a locomotive, it has developed by experiments—trial, error and try, try, again. The game of baseball, of incalculable value in its lessons of skill and coordination, developed from "two-old cat" and "rounders." A locomotive of 100 years ago is a joke in comparison with the latest one, but it was worthwhile in its day and led to what we have. The most wonderful of all organisms is that of man's own body, internally and with its limbs, and how did that come to be what it is, but by ages of development?

The Fundamental Principle

It is useless to plan for "order" and "stability" in economic relations without attention to the basic principle underlying such relations, which is specialization and exchange. Business consists of exchanging services, and there is no limit upon the volume but in present capacity of production and the readiness of the people to agree upon the terms of the exchanges. The secret of prosperity is in balanced relations—value for value in exchanges of different kinds. *Balance, not force or authority, governs in economic relations.*

If the fact could be clearly fixed in the minds of all peoples that the losses and miseries of this worldwide Depression have been caused by the War, better results might be had from disarmament conferences. War is the most violent of all disturbances affecting highly organized society. Invariably it has been followed by industrial and trade disorder; it is a menace to civilization, and the only remedy for it is in a better understanding of economic relations.

The relations of the economic system are too intricate, irregular and vast in number to be regulated from above. They are the affairs of everyday life, the give and take adjustments of living together, and everyone knows, when he stops to think, that these cannot possibly be dispensed with. We have learned nearly all we know in that very school from each other. It is a commonplace that the only way any faculty can be developed is by using it, for this is taught from the cradle through life. A boy cannot be trained for life by having his problems solved for him. However excellent the schools for teaching business principles may be, no one will learn much about business until he is in it, exercising his judgment and bearing responsibility. The principles that are taught have been developed and demonstrated in actual business.

Sociology teaches that next to the influence of family life the most powerful influence for the development of civilization has been that arising from the contacts of men in economic relations. Emerson in his essay on Civilization says that "chiefly the seashore has been the point of departure, to knowledge, as to commerce. The most advanced nations are always those who navigate the most. The power which the sea requires in the sailor makes a man of him very fast, and the change of shores and population clears his head of much nonsense about the wigwam." And in the same essay the author quotes Montesquieu as saying: "Countries are well cultivated, not as they are fertile, but as they are free," adding that "the remark holds not less but more true of the culture of men than of the tillage of the land."

The chief of social ends is the development of the individual in his latent capacities, and to accomplish this there is no substitute for the cooperation which the economic system affords in infinite variety. One of the lessons taught is that the gains from the system of specialization and exchange are dependent upon cooperation, and that if this cooperation is lacking the system will fall short of its purposes, possibly so far as to suggest a general demand for subsistence homesteads, a return to primitive conditions. Another lesson is that in all his contacts with natural forces man must conform to natural law, or suffer the consequent penalties; also that this natural law applies to human relations. And the final lesson is that the system requires for its development the same methods of cooperation and achievement in mutual understanding which developed the Common Law and the Constitution of the United States.*

*Note: Legal history teaches that the science of jurisprudence, without which progress would have been impossible, is not the work of the few but of the many, not the work of lawgivers or of great men, but the steadily and silently built structure of voiceless millions, "who bravely led unrecorded lives and dwell in unvisited tombs." * * * Each one of the community was driven to conform to customary ways of acting. This fundamental instinct is still as intense in us as in the original man. It is for the law the most important instinct of the animal man, for upon it and not upon force or authority has depended the growth and development of law. But it fixes once for all, the important fact that law cannot be changed any faster than the mass of the community changes in opinion or belief. The most absolute despot that has ever lived, the force of legislation or the irrefutable arguments for change, cannot impose upon men a change in law until the mass of the community is ready to accept or has already accepted the change.—From "The Story of the Law," by John M. Zane, with introduction by James M. Beck; published by the Garden City Publishing Company, Garden City, N. Y.

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